KPMG report: Initial observations on round 4 of CAMT guidance in Notice 2023-64

September 25, 2023

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Overview

The U.S. Treasury Department and IRS (collectively referred to as "Treasury" herein) on September 12, 2023, released Notice 2023-64 [PDF 332 KB] (72 pages) (the "Notice") providing additional interim guidance on application of the new corporate alternative minimum tax ("CAMT") created by Pub. L. No. 117-169 (commonly called the "Inflation Reduction Act of 2022" ("IRA")). CAMT, which generally imposes a 15% minimum tax on the adjusted financial statement income ("AFSI") of large corporations whose three-year average annual AFSI exceeds $1 billion ("applicable corporations"), applies for tax years beginning after December 31, 2022.

The Notice clarifies and supplements Notice 2023-7 [PDF 248 KB] (read *TaxNewsFlash*) and Notice 2023-20 [PDF 112 KB] (read *TaxNewsFlash*), issued earlier this year. Treasury has also released a draft version of the 2023 Form 4626, which was released without accompanying instructions but illustrates the extensive CAMT reporting that will be required for 2023, including by corporations that are not applicable corporations and applicable corporations without a CAMT liability. KPMG has published various reports and articles on such guidance to date.[1] Further background information on CAMT is available on a dedicated KPMG website.

Notice 2023-64 contains numerous new defined terms, which are capitalized in the guidance and below. Capitalized terms used but not defined in this report have the definitions provided in the Notice.

Key takeaways

The Notice addresses a number of issues regarding the application of the CAMT regime that remained after the guidance provided in previous notices. However, many prior taxpayer comments remain unaddressed and certain provisions of the Notice create additional concerns and uncertainties. The below sections summarize the provisions of the Notice and provide KPMG observations as to the key issues addressed and raised. Notable provisions and observations include:

- **Taxpayers can perform 2023 CAMT work now**. The best news is that taxpayers have options with respect to the application of CAMT for their 2023 tax years and should feel comfortable preparing their 2023 CAMT calculations *now* based on the statute and/or guidance issued to date. Specifically, the latest guidance states that Treasury anticipates publishing proposed regulations that will apply for tax years beginning on or after January 1, *2024* (not, as previously indicated, tax years beginning on or after January 1, *2023*). This appears to allow taxpayers, for pre-2024 tax years, to rely on reasonable interpretations of the statutory language and, at their discretion, the notices issued to date.

- **The guidance to-date foretells an extremely complex regime.** The Notice, consistent with prior notices, indicates that Treasury will not shy away from complexity in building out the CAMT regime. However, since Treasury has made the sensible decision to not make the rules described in the Notice

[1] *See e.g.*, KPMG report: Initial observations of Notice 2023-7; CAMTyland Adventures, Part I: How to Play the Game — Corporate Alternative Minimum Tax Basics | Tax Notes; CAMTyland Adventures, Part II: 'Right-Sizing' in the Licorice Lagoon | Tax Notes; KPMG report: Observations from Notice 2023-20. See also KPMG Estimated Payment Comment Letter; KPMG Foreign Tax Credits Comment Letter; KPMG Treatment of M&A Transactions Comment Letter; KPMG Depreciation Comment Letter; KPMG Comment Letter Relating to the Distributive Share of Partnership Adjusted Financial Statement Income; KPMG Comment Letter Relating to Application of CAMT Adjustments under Notice 2023-7 to the Distributive Share of Partnership Adjusted Financial Statement Income; KPMG Comments on the Treatment of CFC Dividends and Partnership Taxes for KPMG-authored comment letters and KPMG's Form 4626 TaxNewsFlash.

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(and the prior notices) mandatory for 2023, taxpayers and their advisors will have some time to attempt to understand CAMT and put in place systems to comply with this complex new regime.[2]

- **The Notice contains some discrepancies**. There are multiple instances where different sections of the Notice do not appear to directionally align. For example, Section 5.02(2) of the Notice clearly states that financial statement income ("FSI") should not reflect amounts included in retained earnings. However, the Notice clearly requires taxpayers to adjust FSI by any cumulative adjustments reflected in retained earnings to compute AFSI. As another example, for scoping purposes, the Notice turns off the distributive share rule for partnerships generally, but simultaneously indicates the distributive share rule applies to partnerships owned by controlled foreign corporation ("CFCs").

- **The Notice provides instructions on which financial statement to use for CAMT**. The Notice provides taxpayers a strict hierarchy of which financial statement is the correct applicable financial statements ("AFS") that departs from section 451(b)(3) in many important respects. Notably, a U.S. taxpayer (as defined by the Notice and described below) that is a member of a foreign-parented multinational group ("FPMG") and is included in consolidated financial statements with the FPMG ("FPMG Consolidated AFS") must use the FPMG Consolidated AFS, even if the taxpayer prepares its own separate financial statements under U.S. generally accepted accounting principles ("GAAP"). Often, the FPMG Consolidated AFS will be prepared under international financial reporting standards ("IFRS") or other non-US GAAP and pushing down any U.S. GAAP to IFRS conversion adjustments may be burdensome.

- **Guidance requires "cracking" consolidated financial statements in many instances, with complex rules regarding elimination entries**. When determining FSI and AFSI for a taxpayer that is a member of a Consolidated AFS, the Notice sets forth a process where entities essentially "undo" their book consolidation process and then "redo" it using a process described in Sections 5 and 6 of the Notice. The process set forth is complex. For example, elimination entries in the Consolidated AFS are generally disregarded.

- **No relief (yet?) for book mark-to-market amounts and extraordinary items.** The Notice clearly states that items of income, expense, gain, or loss need not be recognized or realized for regular tax purposes to be included in AFSI (regardless of whether they are nonrecurring). As such, taxpayers with large mark-to-market gains and nonrecurring items (e.g., book gain from the taxable sale of a business) reported in FSI may unexpectedly find themselves qualifying as applicable corporations within the scope of CAMT and/or paying additional CAMT. However, the Notice does request comments regarding mark-to-market gains and losses.

- **Other comprehensive income ("OCI") clearly excluded from CAMT base.** The Notice does eliminate previous uncertainty by clarifying that FSI does not include amounts recorded in OCI.

- **No relief (yet?) for CFC double counting issue**. The Notice acknowledges that the application of the CAMT statute to CFCs has the potential to double count CFC income in AFSI but offers no relief in this area. However, the Notice requests comments on this issue.

- **Definition of FPMG expanded.** For purposes of applying the FPMG $1 billion test, the Notice provides that AFSI includes both (1) the AFSI of all other members of the FPMG, *and* (2) the AFSI of all persons treated as a single employer under section 52 (whether or not such persons are members of the FPMG). Under the statute and prior guidance, it appeared that AFSI for purposes of the FPMG $1 billion test would only take into account members of a book consolidated group.

[2] Note that while estimated tax penalties related to CAMT are waived for 2023 (*see* Notice 2023-42), it is not anticipated that such penalties will be waived for 2024 estimated tax payments.

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- **Partnership scope rule generally simplified**. Corporate partners generally will not need additional information from partnerships to determine if they are in scope. Note, however, that the Notice raises questions as to the calculation of FSI for a taxpayer that book consolidates an investment in a partnership.

- **Section 52(b) addressed; unclear the practical impact, if any, of the change**. The Notice appears to indicate that Treasury intends to change the constructive ownership rules applicable under section 52(b) that apply for scope purposes. One possible reason for such a change is to prevent "breaking" aggregation through intermediate non-corporate entities that are not engaged in an active trade or business. However, the practical impact of this change is unclear.

- **Partnership foreign taxes eligible for CAMT foreign tax credit ("CAMT FTC")**. The Notice clarifies that an applicable corporation or CFC partner can credit its share of foreign income taxes paid at the partnership level for CAMT.

A deeper dive

Section 3: Definition of taxpayer

The guidance defines "Taxpayer" as *any entity*, regardless of whether such entity is subject to any internal revenue tax.[3] Thus, for purposes of the Notice, a Taxpayer includes partnerships (including foreign partnerships) and any entity disregarded as an entity separate from its owner. However, other provisions in the Notice alter the definition of Taxpayer in certain instances, which are discussed further below under the relevant sections.

KPMG observation

CAMT calculations will require taxpayers to start with data from their financial accounting systems; however, many financial accounting systems do not record the tax classification of entities (e.g., whether an entity is regarded or disregarded for federal income tax purposes). Therefore, the Notice may require applicable corporations to re-examine their current systems.

Sections 4 and 5: Determining a taxpayer's AFS and AFSI

General financial statement priority

The Notice contains a hierarchy of financial statements for purposes of determining a taxpayer's AFS. Section 56A(b) defines an AFS by reference to section 451(b)(3) or as specified by Treasury in regulations or other guidance. However, the Notice does not directly reference section 451(b)(3), but rather exercises the authority given to Treasury to define an AFS beyond the realm of section 451(b)(3). It generally maintains and expands the hierarchy provided in that section by prioritizing five categories of financial statements (listed in order): (1) U.S. GAAP statements, (2) IFRS statements, (3) other government and regulatory statements, (4) unaudited external statements, and (5) federal income tax or information returns filed with the IRS. Ordering rules exist within certain of these categories and special rules for tax consolidated groups and foreign-parented multinational groups, discussed below, exist. It is noteworthy that the fifth and lowest category of the hierarchy includes federal income tax or information returns filed with the IRS, a category which does not exist under current section 451(b)(3) rules.

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[3] Under section 7701(a)(14), the term "taxpayer" means any person subject to any internal revenue tax.

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The Notice mirrors the language in Treas. Reg. §1.451-3(a)(5)(iv) for taxpayers that have different financial accounting and tax years and are required to file both annual financial statements and periodic financial statements covering less than a year with a government or government agency. In such a situation, the taxpayer must prioritize the annual financial statements over the periodic financial statements.

KPMG observation

The AFS hierarchy provided in the Notice expands upon the list of acceptable financial statements taxpayers are given (and familiar with) under section 451(b)(3) to also allow taxpayers to treat as its AFS an unaudited (or audited but not certified) external financial statement or a federal income tax or information return filed with the IRS if no financial statement of higher priority exists. However, the Notice adopts a strict hierarchy and does not appear to provide optionality as to which financial statement is the taxpayer's AFS for CAMT purposes. The rules result in every U.S. tax filer clearly having an AFS, but it appears possible for a non-U.S. tax filer not to have an AFS.

Restated AFS

In the event of a restatement of the AFS ("Restated AFS"), the Notice prioritizes the Restated AFS over the previously issued AFS ("Original AFS") for purposes of determining FSI if the taxpayer has not yet filed its federal income tax return for such tax year. The Notice defines a Restated AFS as a revised AFS for a specific accounting period that is reissued to correct the Original AFS for that accounting period. A Restated AFS does not include adjustments to the financial results of a prior accounting period that are disclosed in the notes of an Original AFS for comparison purposes. Section 11 of the Notice provides the steps a taxpayer is required to take if FSI for a tax year is restated after the taxpayer files its original federal income tax return for such tax year.[4]

KPMG observation

Under the U.S. GAAP rules, in a "Big R" restatement[5] (where the error is determined to be material to the prior period financial statements), the prior period financial statements are restated and reissued, and users are notified that financial statements previously filed should no longer be relied upon. Alternatively, in a "little r" restatement (where the error is determined to be immaterial to the prior period financial statements but a correction in the current period would materially misstate the current period financial statements), errors are corrected in current-period comparative financial statements by revising prior period information the next time financial statements are issued, without actually reissuing prior period statements, and disclosing the error. Although Section 4.02(3) of the Notice defines a Restated AFS in terms that describe a "Big R" restatement, Section 11.02(3)(c) of the Notice essentially dictates that a taxpayer will be deemed to have restated its AFS for the preceding year any time retained earnings is adjusted (*e.g.,* for a "little r" restatement). Should a deemed restatement occur, the taxpayer is required by the Notice to adjust AFSI under the rules of Section 11 described below.

AFS for a group of entities

[4] Section 11 of the Notice provides rules governing AFSI adjustments to prevent certain duplications and omissions.

[5] Accounting Standards Codification ("ASC") 250, *Accounting Changes and Error Corrections*, provides guidance for certain accounting changes or error corrections that require special accounting or disclosures for U.S. GAAP purposes (Available at: [250 Accounting Changes and Error Corrections (fasb.org)](). See also [KPMG Handbook: Accounting changes and error corrections (August 2022)]()).The reporting required for the correction of an error depends on the materiality of the error to either the current or prior period financial statements. In the case of error corrections that could misstate either the current or prior period financial statements, there are two types of restatements—a "Big R" restatement and a "little r" restatement.

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In the context of a tax consolidated group ("TCG") or a FPMG, the Notice generally prioritizes the AFS of the parent of the group. For all other taxpayers, the Consolidated AFS is the taxpayer's AFS unless the taxpayer separately reports its financial results in an AFS ("Separate AFS") which is of equal or higher priority to the Consolidated AFS, in which case the Separate AFS is the taxpayer's AFS.[6]

KPMG observation

The application of the TCG Consolidated AFS rule may result in the AFS that is used for CAMT purposes being different than the AFS that is used for section 451 purposes (income recognition for regular tax purposes). In addition, the exception for taxpayers that are members of FPMGs essentially becomes the rule for determining the AFS for any such member. Said differently, the rule in the Notice generally mandates that a U.S. taxpayer that is a member of a FPMG use a non-US GAAP FPMG Consolidated AFS as their AFS, even if the U.S. taxpayer files its own U.S. GAAP statements. A myriad of complications may arise from this rule from a practical application standpoint when determining the taxpayer's CAMT liability. The U.S. GAAP and IFRS accounting standards are not fully converged (and are unlikely to be in the near future).[7] Thus, when an IFRS-reporting FPMG consolidates the results of members that report financial results under U.S. GAAP, there may be an exercise to compute U.S. GAAP to IFRS adjustments and accounting policy alignment to present consolidated results under IFRS. These adjustments are, in some cases, prepared topside as part of the consolidation process, whereas a requirement to use FSI as reported under IFRS requires pushing such adjustments down to determine the taxpayer's FSI. Additionally, a requirement for a taxpayer to use FSI as reported under IFRS would force a taxpayer that normally reports its own results under U.S. GAAP to reflect FSI that does not reflect the economic reality of how it reports transactions to U.S. stakeholders and how management views the transactions.

The rule also raises questions in the M&A context. For example, if a U.S. subsidiary of a U.S.-parented group is acquired by a FPMG, it is unclear when the subsidiary's AFS "changes" to reflect IFRS standards and how such change impacts AFSI. The rules of Section 11 of the Notice governing the use of a different priority AFS in consecutive tax years (described below) appear relevant.

Definition of AFSI and FSI

The Notice confirms that AFSI is generally computed as FSI, as adjusted by section 56A or regulations or other guidance issued under section 56A. Adjustments to FSI outside of those prescribed under section 56A are not permitted under the Notice. However, if a taxpayer's AFS for a tax year is a federal income tax return or information return filed with the IRS, the taxpayer's AFSI is the taxpayer's taxable income for such tax year.

FSI is the net income or loss of the taxpayer, as set forth on the taxpayer's AFS for the tax year. The Notice clarifies that FSI includes all items of income, expense, gain, and loss reflected in the net income on the AFS for the tax year, including nonrecurring items and income or loss from discontinued operations. The Notice does eliminate previous uncertainty concerning whether AFSI is based on net income and whether items in OCI are included. Specifically, the Notice clarifies that FSI does not include amounts reflected in places other than net income on the AFS, such as amounts reflected in retained earnings and OCI.

Notably, the Notice indicates that items of income, expense, gain or loss need not be recognized, realized, or otherwise taken into account for regular tax purposes to be included in AFSI. As a result, amounts included in FSI because a taxpayer uses a fair value or mark-to-market method of accounting under U.S.

[6] This rule is consistent with Treas. Reg. § 1.451-3(h)(1)(i).
[7] See KPMG Handbook: IFRS compared to U.S. GAAP (December 2022) for a side-by-side comparison of IFRS and U.S. GAAP standards.

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GAAP or IFRS may include gain or loss in AFSI before inclusion in taxable income for regular tax purposes (unless the statute or guidance provides otherwise).

KPMG observation

Section 5 of the Notice appears to indicate that Treasury rejected comments requesting that mark-to-market amounts and nonrecurring (e.g., extraordinary) items be excluded from AFSI and comments asking for the general import of tax realization and recognition principles. Given the potential magnitude of mark-to-market amounts in FSI (e.g., because of commodity price swings) and nonrecurring items (e.g., book gain from the taxable sale of a business), it appears likely that more corporations will be applicable corporations. For example, if a corporation that otherwise had $750 million in average annual AFSI sold a business and that sale resulted in $900 million of book (and tax) gain, the corporation would become an applicable corporation.

However, as discussed above, the Notice helpfully and clearly indicates that amounts not reflected in the income statement, including items in OCI, are generally not included in AFSI.[8]

Determining FSI from a consolidated AFS

Section 5.02(3)(c) of the Notice contains a series of complex and burdensome rules for determining FSI from a consolidated AFS in situations where a taxpayer is a member of a book consolidated group and the Consolidated AFS is the taxpayer's AFS, as determined under the rules discussed above. Taxpayers are required under these rules to determine their portion of the Consolidated FSI as reported in the Consolidated AFS and such determination is both required to be supported by its books and records used to create the Consolidated AFS and generally required to equal the FSI that the taxpayer would have reported had it prepared a Separate AFS.

The Notice provides a special "no netting" rule. This rule appears aimed at ensuring that FSI numbers that result from applying Section 5.02(3)(c) is the same as if a Separate AFS was prepared. Specifically, the Notice does not permit taxpayers to determine their share of Consolidated FSI by allocating net Consolidated FSI among AFS Group members (i.e., no netting of losses of one taxpayer against income of another taxpayer within the Consolidated AFS, notwithstanding that such amounts are reflected on a net basis in the Consolidated AFS). In determining a taxpayer's FSI from a Consolidated AFS, the Notice directs taxpayers to disregard any AFS Consolidation Entries[9] that eliminate the effect of transactions between the taxpayer and another taxpayer that is a member of the same AFS Group with two exceptions: AFS Consolidation Entries that relate to (1) members of the same TCG or (2) the taxpayer and any DRE of the taxpayer.[10] In addition, AFS Consolidation Entries (such as for shared expenses) which are not reflected in the separate books and records of the taxpayer must be allocated to each taxpayer to which the AFS relates and taken into account in the appropriate taxpayer's FSI.

KPMG observation

In summary, it appears that these rules regarding determining FSI from a consolidated AFS will

[8] See also the colloquy between Senators Wyden and Cardin (117th Cong., 2nd Sess., Cong. Rec. S. 4166 (August 6, 2022)), wherein Senator Wyden states that "for purposes of the corporate alternative minimum tax, Other Comprehensive Income is not included in financial statement income."

[9] AFS Consolidation Entries include financial accounting journal entries recorded in a Consolidated AFS in order to present the financial results of an AFS Group as though all members were a single company, including journal entries to eliminate the effect of transactions between members of the AFS Group, entries to report amounts that are not recorded in the separate books and records of members of the AFS Group, and to correct or adjust amounts that are reported in the separate books and records of one or more members of the AFS Group.

[10] See below for an additional discussion of entries to determine FSI in the case of a taxpayer with an investment in a partnership.

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require most entities to essentially “undo” their book consolidation process and then “redo” it using the process described in Sections 5 and 6 of the Notice (KPMG tax professionals refer to this as “cracking” and “repacking” the Consolidated AFS). The reach of these rules is broad because such rules apply when a Consolidated AFS is the AFS of more than one taxpayer (generally true when the book consolidated group and TCG are non-identical) and apply for both scope and liability determination purposes.

Essentially, each taxpayer within a book consolidated group will need to prepare separate standalone financial statements on a “parent-only” basis in order to determine its FSI. Under U.S. GAAP, parent-only financial statements (which are seldomly prepared in practice) require an entity to present its results on a standalone, unconsolidated basis. This means that if a taxpayer has investments in other entities that it consolidates for purposes of the Consolidated AFS, it must “unconsolidate” those investments in its parent-only financial statements and account for them in a manner similar to the equity method.

The rules around intercompany elimination entries are noteworthy. As background, in the preparation of a Consolidated AFS, all intercompany transactions are fully eliminated. The Notice will require companies to effectively restore many elimination entries for purposes of calculating FSI, which may be difficult depending on how and where intercompany elimination entries are recorded in the consolidation process. Further, because all intercompany transactions are fully eliminated in the consolidation process, companies may have been less diligent in recording all of those transactions in the individual trial balances of each taxpayer. If this latter situation is present, additional steps need to be taken to appropriately present the standalone parent only financial statements.

Lastly, the Notice is clear that if there are amounts (e.g., stock compensation) recorded in Consolidated AFS that (1) relate specifically to a taxpayer, and (2) are not recorded on that taxpayer’s separate books and records (e.g., trial balance), such amounts will need to be “pushed down” to that taxpayer in determining its FSI. Therefore, depending on how a company maintains its internal books and records (e.g., ledger codes, trial balances, etc.), this part of the cracking and repacking process could involve a considerable amount of work.

Special partnership rule

At the end of Section 5.02(3)(c)(iii) (i.e., the section addressing elimination journal entries), there is a sentence that addresses partnership investments (the “partnership sentence”). The partnership sentence states:

> In the case of a Taxpayer that has an investment in a partnership, the FSI of the Taxpayer with respect to such investment must be determined as though the Taxpayer prepared a Separate AFS in which such investment was properly accounted for under the relevant accounting standards for investments in other entities (for example, under the equity method described in Accounting Standards Codification (ASC) 323), when the Taxpayer does not so account for the investment in its separate books and records used to prepare the Consolidated AFS.

The partnership sentence appears to say that if a taxpayer is a partner, there may be a special FSI computation and inclusion with respect to partnership income for purposes of the partner’s own FSI.

KPMG observation

As an initial matter, it is unclear as to what situations the partnership sentence applies—that is, whether it applies anytime the taxpayer (i.e., the partner) is a member of the consolidated AFS group (regardless of whether the partnership investment itself is) or whether it applies only when the taxpayer *and* the partnership are both members of the same Consolidated AFS. It is also unclear what the partnership sentence means. For example, it is not clear what the reference to the “relevant

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accounting standards for investments in other entities" means. Specifically, if the investee partnership is a member Consolidated AFS, then it appears that the relevant accounting by the taxpayer (i.e., the partner) would be the consolidation method. However, such a reading renders the rule meaningless and is not consistent with the illustration of the rule contained in the Notice example (discussed below). One can query if Treasury meant the partnership sentence to refer to accounting standards exclusive of consolidation. Given the example, this seems reasonable. However, if that was the intent, it raises additional questions of how the taxpayer would determine the "relevant accounting standards" with respect to its partnership investment.

The example in Section 5.02(3)(c)(vii),[11] which cites the partnership sentence, appears to suggest that the taxpayer should not follow the accounting standards used for purposes of preparing the consolidated financial statements and instead account for its investment under the equity method of accounting. Assuming the partnership sentence generally is meant to tell taxpayers to apply the equity method, the example raises questions regarding how taxpayers should apply the equity method (e.g., whether the rules with respect to partial eliminations apply[12] and how equity method basis difference amortization and impairment are treated).

Lastly, as discussed below, Section 13.04 of the Notice addresses the income inclusion amount with respect to a partnership for scope purposes and cross-references both Section 5.02(3)(c)(iii) and 5.02(3)(c)(vii). This would suggest that Treasury intended the partnership sentence to (1) be read in conjunction with Section 13.04 and (2) apply only for scope determination purposes when (i) the partnership is book consolidated with a corporate partner; (ii) the partnership is not a member of the corporate partner's section 52 group; and (iii) the partnership is not a member of the corporate partner's FPMG.

Section 6: Determining FSI, AFSI, and tax imposed for tax consolidated groups

Notice 2023-7 provided that a group of corporations filing as a TCG is treated as a single entity for purposes calculating AFSI. The Notice provides some further guidance on the single entity treatment of a TCG for CAMT purposes.

The Notice provides that if all of the entities included in an AFS are also members of a TCG (or are disregarded entities owned by TCG members), the TCG determines its FSI and AFSI based on the Consolidated AFS, even if a corporation's separate financials are of equal or higher priority. As a result, the FSI reported on the Consolidated AFS is the FSI of the TCG.

By contrast, if the Consolidated AFS contains the financial results of one or more taxpayers that are not members of the TCG, the FSI of the TCG is determined by treating the TCG as a single taxpayer and following the process for determining the FSI of a taxpayer in Section 5.02(3)(c), as described above. For example, the guidance explains that the TCG must ignore each AFS Consolidation Entry and instead *regard* any (1) transaction between a TCG member and another taxpayer, (2) investment of a TCG member in another taxpayer, or (3) investment by another taxpayer in a TCG member. Otherwise, transactions or

[11] In the example, a corporate partner owns a 40% interest in a partnership and both the corporate partner, and the partnership are included in the same AFS Group (presumably because the corporate partner consolidated the partnership for book purposes). However, for purposes of determining the FSI of the corporate partner, it only includes its respective share (40%) of the partnership's loss, despite the fact that it would have included all of the partnership's loss in its consolidated financial statements (i.e., because the corporate partner consolidated the partnership for book purposes). KPMG tax professionals also note that the elimination entry attributable to a transaction between the partner and partnership, which was fully eliminated in the Consolidated AFS, was *fully restored*.

[12] Eliminations entries are often partially restored under the equity method rules (as described in ASC 323). However, the result of fully restoring the elimination entry in the example appears in line with the applicable rules as the transaction between the corporate partner and partnership was for services (not goods).

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investments involving only TCG members remain *disregarded* (i.e., the elimination entries with respect to transactions only involving TCG members are respected).

The Notice clarifies that tax classification is determinative of whether an entity is a member of the TCG. For example, a partnership wholly-owned by members of a TCG is not a member of a TCG, notwithstanding that such entity would be a member if an election were made to treat the entity as a corporation. However, a disregarded entity wholly-owned by a member of a TCG is treated as a member of the TCG.

The Notice provides an example of corporations, X, Y, and Z, that are part of a Consolidated AFS. X and Y are also members of a TCG, while Z is not. In 2023, X sells Asset N to Y for $10 million, and X reports $2 million of gain on its separate books and records. This $2 million gain is eliminated for purposes of the consolidated AFS by an AFS Consolidation Entry and, as the transaction was between members of a TCG, the AFS Consolidation Entry is taken into account in computing FSI of the TCG. Thus, for 2023, the $2 million of intercompany gain is not reflected in FSI. In 2024, Y sells Asset N to Z for $13 million, and Y reports $3 million gain on its separate books and records. This $3 million gain is also eliminated for purposes of the consolidated AFS, but as Z is not a member of the TCG, the elimination of the $3 million gain is not taken into account in calculating the FSI of the TCG. Further, the example provides that “the effect of the 2023 AFS Consolidation Entries on the basis of Asset N is taken into account,” resulting in the TCG including $5 million of gain on the sale of Asset N in 2024 in its FSI.

KPMG observation

This example appears to apply a framework similar to the intercompany transaction rules of Treas. Reg. § 1.1502-13 for TCGs. Effectively, the example treats X and Y as a single entity to calculate gain or loss when the asset is transferred outside the TCG. Neither the consolidated financial statements (which would show no gain or loss) nor the separate company financials of Y (which would show $3 million of gain) would match the $5 million of gain the example states must be included in FSI. Thus, this may represent another instance in which separate “CAMT books” (or at least calculations) must be performed to derive FSI.

The Notice also clarifies that that the CAMT liability of a TCG is determined based on the group’s tentative minimum tax, regular consolidated tax liability, and tax imposed by section 59A (under Treas. Reg. § 1.1502-59A).

Section 7: Determining AFSI with respect to certain foreign corporations

Section 56A(c)(2)(C) requires the inclusion of dividends and “other amounts” with respect to corporations that are not consolidated with the taxpayer for tax purposes (the “dividend inclusion rule"), while section 56A(c)(3) requires inclusion of the taxpayer’s pro rata share of adjusted CFC financial statement items (the “CFC adjustment rule”). The Notice confirms that a U.S. shareholder of a CFC must generally apply both the dividend inclusion rule and the CFC adjustment rule with respect to the CFC.

KPMG observation

Treasury acknowledges in the Notice that the application of both rules has the potential to double count CFC income in a U.S. shareholder’s AFSI, but the Notice offers no relief in this area. However, the Notice requests comments with respect to approaches that “should be considered to address the potential duplication of income with respect to a CFC by reason of the application of [sections] 56A(c)(2)(C) and (c)(3),” including the administrative and compliance burdens of each approach and how such burdens can be minimized.

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The use of the word “duplication” in the request for comments clearly relates to the regulatory authority in section 56A(c)(15)(A) to prevent the duplication of any item. However, there is also authority directly in section 56A(c)(2)(C) itself for Treasury to provide guidance to reduce the amount of dividends included in a shareholder’s AFSI. It is unclear from the request for comments whether Treasury is also considering exercising this authority that would exclude dividends received from a non-tax consolidated corporation that do not implicate obvious double counting concerns (e.g., a dividend received from a non-affiliated domestic corporation for which a section 243 dividends received deduction (“DRD”) is permitted).

There is a particular concern that a dividend paid by a CFC out of section 245A DRD-eligible E&P generated before the effective date of CAMT (“pre-CAMT E&P”) could be included in the AFSI of a taxpayer because the underlying CFC income was not included by the taxpayer under the CFC adjustment rule for CAMT liability purposes. Including dividends out of pre-CAMT E&P in the AFSI of the taxpayer, where such dividends are afforded a section 245A DRD for regular tax purposes, could drive a significant CAMT liability for some taxpayers. This result is arguably inconsistent with the structure of the CAMT regime. Specifically, CAMT is a tax on the annual worldwide AFSI of an applicable corporation, whether earned directly by the taxpayer or, by reason of the CFC adjustment rule, indirectly through CFCs. Thus, including dividends out of pre-CAMT E&P (and reflecting amounts which appeared on a pre-CAMT consolidated financial statement) would effectively subject income generated *before* the effective date of CAMT to the CAMT regime. In other words, this would be tantamount to applying CAMT to pre-effective date income.

KPMG submitted a comment letter on the treatment of CFC dividends in response to Notice 2023-7. In that letter, KPMG tax professionals suggested that, at least as an interim approach, CFC dividends should be excluded from AFSI to prevent double counting and inappropriate single counting of dividends out of pre-CAMT E&P. It cannot be gleaned from the Notice whether Treasury will adopt this simplified approach to alleviate double counting with respect to CFCs, or, alternatively, a more complicated approach, such as a special CAMT regime for previously taxed earnings and profits (PTEP) akin to sections 959 and 961.

The Notice also confirms that a U.S. shareholder’s pro rata share of CFC financial statement items under the section 56A(c)(3) CFC adjustment rule is applied on an aggregate rather than a CFC-by-CFC basis. Accordingly, a U.S. shareholder of multiple CFCs makes a single adjustment under the CFC adjustment rule that is equal to the sum of its pro rata share of the adjusted net income or loss of all CFCs of which the taxpayer is a U.S. shareholder. Such U.S. shareholder includes the single adjustment amount in its AFSI only if the adjustment amount is positive in such year. If negative, no CFC adjustment amount is included in the U.S. shareholder’s AFSI and instead the negative adjustment amount is available to be applied in subsequent years to offset positive CFC single adjustment amounts to the extent thereof in such future year.

KPMG observation

The Notice’s clarification that the CFC adjustment rule applies on an aggregate basis, rather than a CFC-by-CFC basis, is consistent with the relevant statutory language. This clarification is favorable to taxpayers because it allows for a U.S. shareholder’s pro rata share of a CFC’s adjusted net loss to offset such U.S. shareholder’s pro rata share of a *separate* CFC’s adjusted net income, regardless of whether the net loss CFC is tax resident in the same jurisdiction as the net income CFC.

Section 56A(c)(4) provides that a foreign corporation’s AFSI is determined in accordance with section 882 (i.e., U.S. ECI) principles (the “ECI rule”). The Notice clarifies that for purposes of applying the ECI rule, U.S. income tax treaty principles apply if a foreign corporation is eligible for and claims benefits of the business profits provisions under an applicable U.S. income tax treaty.

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KPMG observation

Under the statute, it was not clear when applying the ECI rule whether a foreign corporation's AFSI excluded FSI items connected to a U.S. trade or business if such income was exempt from regular U.S. tax under an applicable U.S. income tax treaty ("treaty-exempt ECI") (e.g., because the foreign corporation does not have a U.S. permanent establishment). This helpful clarification that treaty-exempt ECI is excluded from a foreign corporation's AFSI under the ECI rule is particularly relevant in the CAMT scoping context for certain sovereign wealth fund and foreign pension fund structures, as it is not uncommon for these investment structures to generate significant amounts of such income. The BEAT regulations (Treas. Reg. § 1.59A-2(d)(3)) similarly provide that only amounts attributable to a permanent establishment (if a U.S. tax treaty applies) are taken into account for purposes of the gross receipts test.

The Notice provides a coordination rule for the application of the CFC adjustment rule under section 56A(c)(3) and the ECI rule under section 56A(c)(4) to prevent potential double-counting or double non-counting of CFC income. Specifically, if a CFC is an applicable corporation, the CFC's adjusted net income or loss is reduced by the CFC's AFSI taking into account the ECI rule (i.e., ECI of the foreign corporation that is not treaty exempt). The Notice also clarifies a CFC's adjusted net income or loss is not limited to the amount of CFC AFSI as determined under the ECI rule. Thus, all adjusted net income of the CFC, including treaty-exempt ECI, is taken into account in determining the increase to the AFSI of U.S. shareholders under the CFC adjustment rule.

KPMG observation

It appears that this coordination rule is intended to apply solely to the determination of a U.S. corporation's CAMT liability because the rule's operation is predicated on the CFC's status as an applicable corporation, a fact that could be identified only upon the conclusion of the CAMT scope determination. Accordingly, the potential AFSI double-counting issue involving CFCs that have AFSI under the ECI rule curiously remains unaddressed in the scoping context.

KPMG observation

The Notice's description of the CFC adjustment rule further clarifies that CFCs do not have AFSI except to the extent determined under the ECI rule.

The Notice provides that if a CFC is a partner in a partnership, the CFC's adjusted net income or loss includes the CFC's distributive share of such partnership's AFSI as determined under section 56A(c)(2)(D) and guidance thereunder (the "CFC partner distributive share rule").

KPMG observation

As discussed below, section 13.04(1) of this Notice, citing to Section 7 of Notice 2023-7,[13] recites a rule that turns off the partnership distributive share rule for the scope determination "in all circumstances." Inconsistent with this rule, but possibly as a consequence of the fact that CFCs generally do not have AFSI, the CFC partner distributive share rule would appear to apply for scoping as well as for CAMT liability determination purposes. This apparent requirement to take into account

[13] Notice 2023-7 states "the adjustment to AFSI under § 56A(c)(2)(D)(i) [the distributive share rule] is inapplicable in all circumstances in determining applicable corporation status."

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the CFC partner's distributive share of partnership AFSI when determining the U.S. shareholder's pro rata share of CFC items for scoping purposes would pose administrability and compliance burdens. For example, the section 56A(c) adjustments to partnership items would need to be made whether or not the U.S. shareholder and the partnership were members of the same section 52 single employer group or FPMG and, based on the Section 13 rule, Treasury seems to think this burden is generally inappropriate. It is also unclear why section 13.04(1) of this Notice and Section 7 of Notice 2023-7 use the words "in all circumstances." U.S. shareholders holding interests in partnerships through CFCs are apt to be confused and Treasury should clarify the interaction of these rules.

Section 8: AFSI adjustment for certain taxes

In general, section 56A(c)(5) requires an adjustment to AFSI to disregard any federal income taxes or foreign income taxes (within the meaning of section 901) ("foreign income taxes") taken into account on the taxpayer's AFS (the "tax adjustment"). However, the statute provides that, to the extent provided by the Secretary, this general rule does not apply to foreign income taxes taken into account on the taxpayer's AFS if the taxpayer does not choose to claim a foreign tax credit under section 27 (a "regular FTC").

KPMG observation

Thus far Treasury has not exercised the authority in section 56A(c)(5) to limit the adjustment with respect to foreign income taxes to taxpayers that elect to credit, rather than deduct, regular FTCs. Therefore, companies that do not choose to credit regular FTCs nonetheless must add back the foreign income taxes taken into account on their AFS in computing AFSI, both for purposes of the liability and scope determination. With respect to the liability determination, requiring a tax adjustment for taxpayers that deduct, rather than credit, their foreign income taxes could have the effect of overstating such taxpayers' AFSI relative to their taxable income, thus potentially generating an inappropriate CAMT liability. In contrast, with respect to the scope determination, it would be difficult to discern a policy rationale for requiring the tax adjustment for crediting taxpayers but not deducting taxpayers, since a company's decision to credit or deduct would appear to have no relationship to a company's "bigness" for purposes of CAMT.

The statute directs Treasury to issue regulations or other guidance addressing the proper treatment of current and deferred taxes for purposes of the tax adjustment, including when such taxes are properly taken into account. In response to this authority, the Notice clarifies that a tax adjustment may be either positive (in the case of a tax expense) or negative (in the case of a tax benefit) and that a current or deferred federal or foreign income tax results in a tax adjustment in the year that such tax increases or decreases the taxpayer's FSI. Specifically, the Notice provides that the section 56(c)(5) adjustment (1) includes federal and foreign income taxes that are accounted for as deferred tax expense (benefit), as current tax expense (benefit), or through increases or decreases to other AFS accounts (such as those that are used to account for FSI from investments in other entities under the equity method), and (2) is made in the tax year(s) in which such taxes increase or decrease the taxpayer's FSI or are included as a component of an adjustment to AFSI described in Section 11.02 of the Notice (i.e., AFSI adjustments prescribed under section 56A(c)(15) to prevent certain duplications and omissions, discussed further below).[14] The Notice further provides that, for purposes of the tax adjustment and the CAMT FTC (discussed below), a tax is considered to be taken into account on an AFS of a taxpayer if any journal entry has been recorded in the journal used to determine amounts on the taxpayer's AFS for any year (or another AFS that includes the taxpayer) to reflect the tax, even if the tax does not increase or decrease the taxpayer's FSI at the time of the journal entry.[15] Further, a tax that is taken into account on a partnership's AFS is considered to be taken into account on any AFS of its partners.

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[14] Section 8.02(1) of the Notice.
[15] Section 8.02(2) of the Notice.

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KPMG observation

The Notice provides welcome clarity on the scope of the tax adjustment to AFSI. It confirms that the adjustment includes both current and deferred federal and foreign income taxes and makes clear that items stated net of such taxes in a taxpayer's AFS are adjusted to disregard the taxes (i.e., such that the items are accounted for on a pre-federal and foreign income tax basis in AFSI).

The Notice also clarifies that a tax adjustment to AFSI should be made in the tax year in which the tax results in an increase or decrease to FSI, notwithstanding that the foreign taxes accrue for federal income tax purposes in a different year (e.g., by reason of a foreign tax redetermination). However, for this reason, there could be a mismatch between the year for which the CAMT FTC is permitted to be claimed, as discussed below with respect to Section 14 of the Notice, and the year in which the tax adjustment occurs.

Finally, the Notice provides helpful guidance for partners with respect to partnership foreign taxes. Specifically, the provision in the Notice that treats federal and foreign incomes taxes taken into account on a partnership's AFS as having been taken into account on an AFS of its partners permits the partners to claim partnership foreign taxes as CAMT FTCs, including for taxes paid by equity method and fair value-accounted partnerships (as discussed in more detail in Section 14). It also confirms that a partner of an equity method partnership must determine the impact of partnership foreign taxes on its net income or loss with respect to the partnership. But it remains unclear how a partner of a fair value-accounted partnership would determine its tax adjustment with respect to foreign taxes paid by the partnership, since these amounts are only indirectly reflected in the partner's FSI with respect to the partnership (through an increase or decrease in value).

Section 9: AFSI adjustments for section 168 property

Section 56A(c)(13) generally provides for an adjustment to AFSI that replaces financial statement depreciation with tax depreciation. This remove-book-and-replace-with-tax depreciation rule is limited to depreciation with respect to certain, generally tangible, property. Specifically, 56A(c)(13) provides that AFSI is (A) reduced by depreciation deductions allowed under section 167 with respect to property to which section 168 applies to the extent of the amount allowed as deductions in computing taxable income for the year, and (B) appropriately adjusted to (i) disregard any amount of depreciation expense that is taken into account on the taxpayer's AFS with respect to such property, and (ii) take into account further appropriate adjustments with respect to the property as specified by Treasury (the "section 56A(c)(13) depreciation adjustment"). Section 9 of Notice 2023-64 clarifies and expands on the guidance provided in Section 4 of Notice 2023-7.[16] Taxpayers that choose to rely on the guidance in Section 4 of Notice 2023-7 on or after September 12, 2023, are required to apply such guidance as modified and clarified by Notice 2023-64.

Adjustments for tax depreciation method changes

It was previously unclear whether the section 56A(c)(13) depreciation adjustment includes section 481(a) adjustments[17] for changes in tax depreciation methods related to property subject to such adjustment. The Notice makes clear that in order to prevent depreciation from being duplicated or omitted under section

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[16] See *KPMG report: Initial observations of Notice 2023-7* (Jan. 4, 2023) for a description of Notice 2023-7, including Section 4 of such Notice

[17] Section 481(a) generally requires a taxpayer to make any adjustment necessary to prevent amounts from being duplicated or omitted that may result from a taxpayer computing taxable income for a tax year using a method of accounting for an item of income or expense that is different from the method used in the preceding tax year. Generally, a section 481(a) adjustment is required to be recognized in taxable income entirely in the year of change for an adjustment that decreases taxable income and over four tax years (beginning with the year of change) in the case of an adjustment that increases taxable income. See also I.R.C. § 446(e) and the regulations thereunder, and secs. 2.06(1) and 3.15 of Rev. Proc. 2015-13, 2015-5 I.R.B. 419.

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56A(c)(13), AFSI is adjusted to take into account any section 481(a) adjustment resulting from a change in method of depreciating section 168 property (1) over the same period as recognized for tax purposes (e.g., in one tax year if negative and over four tax years if positive), and (2) only to the extent such section 481(a) adjustment is taken into account in computing taxable income for the tax year. The Notice provides an example of this rule that illustrates a change in method of accounting for an item of section 168 property resulting in a positive section 481(a) adjustment of $1,000x that is taken into account in computing taxable income ratably over four tax years (2023 through 2026). Under the Notice, the taxpayer increases AFSI by $250x each year (i.e., in 2023 through 2026).

KPMG observation

The inclusion of section 481(a) adjustments for changes in tax depreciation methods for section 168 property subject to section 56A(c)(13) ensures that the proper amount of tax depreciation is taken into account in adjusting AFSI. Such inclusion is also consistent with the treatment of section 481(a) adjustments under other provisions of the Code requiring depreciation adjustments.[18]

Under the Notice, only section 481(a) adjustments resulting from a change in depreciation method are covered by this rule, and the Notice does not provide guidance for the treatment of section 481(a) adjustments that relate to a change from capitalizing to expensing, or vice versa, with respect to section 168 property. Such an adjustment would presumably have an impact on historical AFSI as it would result in a taxpayer changing from historically making an adjustment to AFSI for depreciation under section 56A(c)(13) to treating the property as not giving rise to an adjustment to AFSI. The government is clearly concerned with the accuracy of cumulative AFSI given their focus on capturing adjustments made to financial statement retained earnings in Section 11 of the Notice, as discussed below. The Notice does request comments as to the appropriate treatment of a section 481(a) adjustment in this scenario.

Adjustments for depreciation capitalized and recovered under other Code sections

Notice 2023-7 clarifies that the section 56A(c)(13) depreciation adjustment includes both depreciation allowed as a deduction in computing regular taxable income and the amount recovered through cost of goods sold in the current tax year of depreciation allowances capitalized to inventory. Notice 2023-64 expands on this by providing that the depreciation adjustment to AFSI also includes depreciation capitalized and recovered in the current tax year under other provisions of the Code (e.g., depreciation capitalized under section 174 and included in the amortization deduction for the current tax year, and depreciation capitalized to non-inventory property and recovered as part of the gain or loss from the sale or exchange of the property in the current tax year).

KPMG observation

Notice 2023-7 previously clarified that depreciation expense capitalized to inventory under section 263A and recovered as part of cost of goods sold in computing taxable income for the tax year is included as part of the section 56A(c)(13) depreciation adjustment. The extension of this rule by Notice 2023-64 to also include depreciation that is capitalized and recovered under other provisions of the Code (e.g., whether through amortization or by an adjustment to the basis of property when sold) ensures accounting for the section 168 property consistently for both regular tax and CAMT purposes. Unlike in the case of inventory property, where under the FIFO method capitalized

[18] See, e.g., CCA 202123007 (May 10, 2021) (requiring a section 481(a) adjustment resulting from a change in depreciation method to be included in the depreciation adjustment in determining adjusted taxable income under section 163(j)(8)(A)(v) (for a tax year beginning before 2022), but only to the extent taken into account in computing taxable income for the tax year).

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depreciation will generally reverse in the next year, the application of this rule to other accounts that may turn more slowly over a period of years, although taxpayer-favorable, can be expected to cause additional recordkeeping burden.

Adjustments related to dispositions of section 168 property

Notice 2023-7 provides guidance regarding AFSI adjustments for dispositions of section 168 property. A taxpayer that disposes of section 168 property must adjust AFSI to redetermine any gain or loss taken into account in the taxpayer's AFS. This adjustment is made by adjusting the taxpayer's AFS basis in the section 168 property to take into account all current and prior adjustments under section 56A(c)(13) as if the taxpayer had been subject to CAMT in all prior years (including years prior to the effective date of CAMT). These adjustments generally have the effect of preventing a duplication or omission of basis recovery that would otherwise result from either claiming tax depreciation expense faster than book depreciation, or vice versa, or because of a difference between the unadjusted book and tax basis of the property.

Although Notice 2023-7 treated AFS impairments and impairment reversals as book depreciation expense, it did not specify whether the ultimate AFS disposition event or the tax disposition event governs when the disposition adjustments are taken into account in determining AFSI gain or loss. This additional guidance provides that the year of the tax disposition event (including an abandonment) is when the cumulative AFSI adjustments are taken into account. For example, the Notice addresses situations where a taxpayer takes a disposition loss (including an abandonment loss) into account in its AFS with respect to section 168 property in a tax year that is earlier than the tax year in which the disposition is recognized for tax purposes. Specifically, the Notice requires a taxpayer to adjust AFSI for the earlier year to disregard the disposition loss included in its AFS for that tax year, effectively treating the disposition loss the same as depreciation and impairments that are removed from AFSI, and instead requires the taxpayer to redetermine an AFSI gain or loss in the tax year in which the disposition event occurs for regular tax purposes.

KPMG observation

Notice 2023-64 expands on the list of depreciation adjustments required in determining AFSI on an annual basis. Beyond the enumerated items discussed above, the Notice also provides for additional adjustments for "other items as provided in regulations or other guidance," thus limiting these adjustments to those provided, specifically in guidance. In contrast, upon a tax disposition event, in addition to requiring the specifically enumerated adjustments, the Notice requires "any other adjustments to AFS basis required under section 56A, regulations, or other guidance." Although not free from doubt, the difference in language suggests that disposition adjustments might be required or permitted even if not specifically enumerated. Further, the requirement that the AFSI adjustment be made in the year in which the disposition event occurs for regular tax purposes implies that a taxpayer who makes a partial disposition election upon the partial disposal of an asset that is section 168 property should be able to adjust AFSI for such loss in the year of the partial disposition.[19]

The Notice also provides an example of a calendar-year taxpayer who claimed 100% bonus depreciation on section 168 property in 2018 (cost of $1,000x) that is depreciated on a straight-line basis over 40 years for AFS purposes (i.e., book depreciation of $25x/year), and subsequently disposes of the property January 1, 2024, for $900 (for both AFS and tax purposes). In determining the AFSI basis of the property in 2024, the example illustrates how (1) the cumulative AFS depreciation ($150x[20]) is added back to the remaining AFS basis ($850x[21]) in 2024, and (2) the bonus depreciation claimed ($1,000x) reduces such basis to zero.

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[19] See Treas. Reg. sec. 1.168(i)-8(d). Note that a partial disposition election is not available if the property is in a general asset account ("GAA"). See I.R.C. § 168(i)(4) and Treas. Reg. § 1.168(i)-1 for the rules governing GAAs.
[20] $25x x 6 years = $150x.
[21] $1,000x - $150x = $850x.

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As a result, the gain that is taken into account in the taxpayer's AFS ($50x[22]) is adjusted (by $850x) to reflect the redetermined gain for AFSI purposes ($900x) in 2024.

KPMG observation

The adjustments to AFSI related to dispositions of section 168 property ensure that appropriate adjustments are made to the book basis of an asset and related gain or loss in the AFS in order to reflect the tax basis of the section 168 property and the timing of the realization of the disposition event for tax purposes. Given the need for these adjustments to be made on a property-by-property basis, it is unclear how these rules apply when a taxpayer uses multiple asset accounting for regular tax depreciation purposes. Such adjustments may impose significant administrative burdens on taxpayers that could outweigh the benefits of the section 56A(c)(13) adjustment. The need to separately track on a property-by-property basis the cumulative amount of previously recognized book and tax basis differences for gain or loss purposes adds considerable complexity to fixed asset accounting. In situations where tax depreciation is affected by deferred intercompany gain or loss on intercompany transactions, an additional layer of complexity is introduced.

Adjustments only apply to property depreciated under sections 167 and 168

Notice 2023-7 made clear that section 56A(c)(13) only applies to the portion of the cost of property that is depreciated under sections 167 and 168. Notice 2023-64 further clarifies that no adjustment to AFSI is made with respect to property that is not depreciated under sections 167 and 168 for regular tax purposes. Thus, for example, federal income tax depreciation with respect to foreign property held by a taxpayer not subject to federal income tax need not be computed in determining AFSI. The Notice further indicates that the rules for determining the applicable corporation status of members of a FPMG (discussed further below), including the rule that disregards the adjustment to AFSI under section 56A(c)(4) (for determining the AFSI of certain foreign corporations, as discussed above), do not change this result.

KPMG observation

The Notice provides helpful clarification that for purposes of determining AFSI (as would be relevant only for scoping) a foreign taxpayer (other than a CFC) does not have to make an AFSI adjustment under section 56A(c)(13) for depreciation on property that would otherwise be depreciated under sections 167 and 168 if the taxpayer was subject to U.S. tax. For foreign parented groups, this clarification prevents the need for the foreign entities in the group to recompute their depreciation using U.S. tax principles, when such groups would not otherwise be required to undergo what could be a burdensome exercise.

Adjustments for amounts recognized in FSI for dispositions of section 168 property

Notice 2023-7 provided for AFSI step-in-the shoes treatment for certain corporate and partnership transactions that are non-recognition transactions for federal income tax purposes. These rules turn off and disregard AFSI gain or loss, and the resulting basis adjustments with respect to these transactions. Notice 2023-64 takes a different approach for stand-alone dispositions of section 168 property. In the case of such dispositions, if gain or loss from the disposition is recognized in its FSI, such gain or loss (as redetermined under the Notice) is generally recognized for AFSI purposes regardless of whether any gain or loss with respect to the disposition is realized, recognized, or otherwise taken into account for regular tax purposes (e.g., deferred under section 1031 (like-kind exchange) or section 453 (installment method)).

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[22] $900x sales proceeds - $850x remaining AFS basis = $50x AFS gain.

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The Notice provides an example of the application of this rule to an installment sale under section 453 of section 168 property, pursuant to which the taxpayer receives payments over a 10-year period. The example illustrates that even though the taxpayer recognizes income as payments are received each year for regular income purposes (based on its gross profit percentage under section 453), the entire amount of the gain (as redetermined as discussed above) is included in AFSI in the year of the installment sale.

The Notice provides additional examples of the application of this rule to a like-kind exchange of real property under section 1031 and illustrates that the entire amount of redetermined gain is included in AFSI in the year of the exchange, notwithstanding that a portion is deferred for regular tax purposes. An example also illustrates the amount of redetermined gain included in AFSI for the year in which the replacement property is subsequently sold.

KPMG observation

The non-applicability of tax gain or loss nonrecognition or deferral provisions for AFSI purposes (other than in the context of covered nonrecognition transactions) will increase or in some cases could even cause affected taxpayers to be liable for CAMT in the case of gains that are being deferred for regular tax purposes. In addition to the examples provided in the Notice for gain deferrals under sections 453 and 1031, this seemingly would apply to other tax deferral provisions such as sections 1033 (involuntary conversions) and 1400Z-2 (opportunity zones), unless Treasury provides for an adjustment to AFSI for such provisions in future guidance. Notice 2023-64 does not alter the rules previously provided in Section 3 of Notice 2023-7 to disregard AFSI gain or loss and the resulting basis adjustments with respect to certain corporate and partnership non-recognition transactions.

Section 10: AFSI adjustments for qualified wireless spectrum

The Notice clarifies that the adjustments to FSI under section 56A(c)(14) for Qualified Wireless Spectrum generally mirror the adjustments for depreciation under section 56A(c)(13). Section 56A(c)(14) provides a remove-book-and-replace-with-tax rule related to amortization of Qualified Wireless Spectrum. Qualified Wireless Spectrum is defined in the statute and the Notice as wireless spectrum which is used in the trade or business of a wireless telecommunications carrier and was acquired after December 31, 2007 and before August 16, 2022. While Notice 2023-7 previously provided guidance as to adjustments to FSI with regards to depreciation deductions allowed under section 167, the prior Notice was silent as to the adjustment for section 197 amortization for Qualified Wireless Spectrum.

For Qualified Wireless Spectrum, the Notice describes three types of adjustments that are required: (1) adjustments for tax amortization deductions allowed under section 197 (“Deductible Tax Amortization”), (2) items that originate in AFS income and are required to be removed from AFS income (“Covered Book Amortization Expense” and “Covered Book Wireless Spectrum Expense”), and (3) adjustments for section 481(a) Adjustments for changes in method of accounting for amortization of any item of Qualified Wireless Spectrum. Similar to Covered Book Depreciation Expense,[23] Covered Book Amortization Expense includes amortization expense, disposition loss that occurs prior to the tax year in which the disposition occurs for Regular Tax purposes, impairment loss, or impairment loss reversal taken into account in the taxpayer’s FSI with respect to Qualified Wireless Spectrum. Covered Book Wireless Spectrum Expense includes amounts that are recognized as an expense in the AFS but are reflected in the tax basis for depreciation of the Qualified Wireless Spectrum. Similar to the guidance described above for depreciation section 481(a)

[23] Under section 4.02(2) of Notice 2023-7, as modified by Notice 2023-64 (described above), the term “Covered Book Depreciation Expense” means depreciation expense, disposition loss (including from an abandonment) that occurs prior to the tax year in which the disposition occurs for regular tax purposes, impairment loss, or impairment loss reversal other than Covered Book COGS Depreciation that is taken into account in the net income or loss set forth on the taxpayer’s AFS with respect to section 168 property.

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adjustments, AFSI is reduced by any section 481(a) adjustment for amortization that is negative and increased for any section 481(a) adjustment that is positive, but only to the extent of the amount that is taken into account in computing taxable income for the tax year.

The Notice provides for additional adjustments upon the disposition of Qualified Wireless Spectrum which mirror those provided for dispositions of section 168 property discussed in Section 9 of the Notice. The AFS basis of applicable property is decreased by cumulative Deductible Tax Amortization, increased by Cumulative Covered Book Amortization Expense and Covered Book Wireless Spectrum Expense, and adjusted for the full amount of any section 481(a) adjustment for amortization.

In addition, the Notice clarifies that section 56A(c)(14) does not apply to property which is not subject to amortization under section 197, such as property of a taxpayer that is not subject to U.S. taxation. The Notice further indicates that the rules for determining the applicable corporation status of members of a FPMG (discussed further below), including the rule that disregards the adjustment to AFSI under section 56A(c)(4) (for determining the AFSI of certain foreign corporations, as discussed above), do not change this result.

KPMG observation

The provision of adjustments to AFSI for qualified wireless spectrum property that are similar to those required for section 168 property clears up uncertainty in the application of section 56A(c)(14). The Notice also provides helpful clarification that for purposes of determining AFSI, a foreign taxpayer does not have to make an AFSI adjustment under section 56A(c)(14) for the amortization of qualified wireless spectrum that would otherwise be amortized under section 197 if the taxpayer was subject to U.S. tax. However, the practical complexities and administrative burdens resulting from both section 56A(c)(13) and section 56A(c)(14) cannot be overscored.

Section 11: AFSI adjustments to prevent certain duplications and omissions

Section 56A(c)(15) authorizes the Secretary to issue regulations or other guidance to provide for adjustments to AFSI necessary to prevent the omission or duplication of any item. The Notice identifies three categories of adjustments to AFSI to prevent omissions or duplications: (1) adjustments due to a change in financial accounting principle, (2) adjustments due to restatement of a prior year's AFS, and (3) adjustments identified by an independent financial statement auditor as part of a qualified or adverse opinion. The Notice clarifies that timing differences that result from an item being accounted for in FSI in a different year than it is accounted for in taxable income do not give rise to an adjustment under section 56A(c)(15), even if the timing difference originated prior to the effective date of CAMT and is resolved after the CAMT effective date.

KPMG observation

Many taxpayers have been recommending guidance to provide a means to prevent the omission or duplication of items of income or expense when an applicable corporation transitions into CAMT (or if an applicable corporation encounters a year in which they are subject to regular tax). However, these types of transitional timing differences will not give rise to an AFSI adjustment under the Notice. Without such a transition rule, a taxpayer who receives advance payments which are deferred in FSI beyond two years would be subject to double inclusion of income. Under the accrual method, advance payments are reported on the one-year deferral method[24] – a taxpayer who has adopted

[24] See I.R.C. § 451(c) and Treas. Reg. § 1.451-8.

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this deferral method and received advance payments in 2021 would recognize all advance payments for regular tax purposes by 2022 and would be taxed again in future years under CAMT as the advance payment is recognized in FSI. Similarly, deductions which have not been recognized for regular tax purposes but have been deducted in FSI in pre-CAMT years would seem to be lost to the extent the amounts are not otherwise adjusted for under section 56A(c) and the taxpayer remains in CAMT. However, deductions which are accelerated for regular tax purposes but not FSI purposes in a pre-CAMT year, such as deductions for prepaid expenses under the 12-month rule,[25] would appear to be duplicated in CAMT years.

Financial accounting principle change adjustment

Generally, when a company implements a change in financial accounting principle, a cumulative effect adjustment is reflected in retained earnings in order to adjust cumulative prior period FSI to reflect the adopted method. The Notice requires an adjustment to AFSI to take into account any such cumulative adjustments to retained earnings reflected in the taxpayer's AFS ("Accounting Principle Change Adjustment"). The Accounting Principle Change Adjustment is further adjusted if it relates to items for which other AFSI adjustments are required under section 56A ("Net Accounting Principle Change Adjustment") (e.g., if the Accounting Principle Change Adjustment reflects federal income tax expense which is also subject to an AFSI adjustment under section 56A(c)(5)). The Notice provides that any Accounting Principle Change Adjustment (or Net Accounting Principle Change Adjustment, as appropriate) that is necessary to prevent the *duplication* of income, expense, gain or loss[26] for AFSI purposes must be taken into account in AFSI ratably over a 4-year period, beginning with the year in which the financial accounting principle is implemented. However, such an adjustment may be taken into account over a period other than 4-years (but not to exceed 15 years) if the taxpayer can demonstrate the duplication is reasonably expected to occur over such period. Accounting Principle Change Adjustments (or Net Accounting Principle Change Adjustments, as appropriate) necessary to prevent the *omission* of income, expense, gain or loss[27] for AFSI purposes are taken into account ratably over a 4-year period, beginning with the year in which the financial accounting principle is implemented in the case of a resulting increase to AFSI and entirely in AFSI in the year of change in financial accounting principle for resulting decreases to AFSI. The Notice provides an acceleration rule for any unrecognized Accounting Principle Change Adjustments in the year a taxpayer ceases to engage in the trade or business that is the subject of such change.

A taxpayer is also treated as having implemented a change in financial accounting principle requiring an adjustment to AFSI if the priority of their AFS for the current tax year differs from the priority of the AFS for the preceding tax year.[28] A priority would arise, for example, if a taxpayer converts from reporting under U.S. GAAP to reporting under IFRS. Such a change would require the company to recognize differences between GAAP accounting policies and IFRS accounting policies as an adjustment in retained earnings at the date of transition to IFRS.[29]

Restatement of a prior year's AFS

If a taxpayer restates an AFS, and, as a result, its FSI is altered after the taxpayer has filed its original federal income tax return for that year, the Notice requires the taxpayer to account for the difference in FSI by making an adjustment to AFSI to take into account the cumulative effect of the restatement on FSI in the first original federal tax return filed after the restatement date. For example, if a calendar year taxpayer

[25] See Treas. Reg. § 1.263(a)-4(f).
[26] For example, an adjustment made under ASC 606 to change from recognizing revenue for up-front franchise fees at the point in time when the business is on-boarded to recognizing such revenue over the term of the franchise agreement.
[27] For example, an adjustment made under ASC 606 to change from recognizing revenue for a term-based software license over time to recognizing such revenue at the point in time when the performance obligation is satisfied (i.e., at the time control has transferred).
[28] The rule with respect to instances where the priority of a taxpayer's AFS changes seems to be significant in the M&A context – for example, it would appear to often apply when a U.S. target is acquired by a FPMG and after an IPO.
[29] See IFRS 1.11

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issues a Restated AFS for 2023 in November 2024 (after the taxpayer has filed its original federal tax return for calendar year 2023), it must account for the restatement by adjusting its AFSI for the tax year 2024. Similar to an Accounting Principle Change Adjustment, the restatement adjustment may need to be further adjusted to account for any FSI items subject to other adjustments under section 56A. However, taxpayers are not required to adjust AFSI for restatement adjustments which are included in an amended return or administrative adjustment request ("AAR") under section 6227 filed as a result of the restatement, as the Notice requires the Restated AFS must be used for purposes of determining AFSI on the amended return or AAR.

A discussion of scenarios constituting a restatement of an AFS is included above in Section 4. A taxpayer will also be deemed to have restated its AFS for the preceding tax year (and thus is required to make the adjustments outlined here) if beginning retained earnings in the taxpayer's AFS is adjusted to be different from the preceding year's ending retained earnings, the difference is attributable to items that would otherwise be included in the taxpayer's FSI under the relevant accounting standards, and the taxpayer is not otherwise subject to the adjustments required as part of a restated AFS. For example, a deemed restatement may occur should a company adjust opening retained earnings in its AFS in order to account for the correction of an error in prior periods. Such an adjustment is now required to be reflected as a cumulative catch-up adjustment to AFSI.

Adjustments for amounts disclosed in an auditor's opinion

The third category of adjustments to AFSI to prevent duplications or omissions includes amounts disclosed in a qualified or modified opinion or an adverse opinion issued by an independent financial statement auditor to the extent the disclosed amounts would have increased FSI had they been reported in the taxpayer's AFS. An adjustment to AFSI is not required if the disclosed amounts were included in FSI for a prior year.

KPMG observation

Although it only identifies three categories of adjustments to AFSI to prevent the omission or duplication of any item, the Notice seems to cast a wide net in covering the types of scenarios that will actually give rise to an adjustment under section 56A(c)(15). Through the deemed change in accounting principle and deemed restatement rules, the Notice seems to create a need for an adjustment under section 56A(c)(15) any time retained earnings is adjusted in a taxpayer's AFS such that even the correction of an error would require an AFSI adjustment. Note, however, Section 5.02(2) of the Notice clearly states that *FSI* should not reflect amounts included in retained earnings. It is worth noting that this is not the only instance where different sections of the Notice do not appear to directionally align.

Section 12: Financial statement net operating losses

Section 56A(d) provides for a reduction to AFSI for financial statement net operating losses ("FS NOLs"). Specifically, for liability determination purposes only, AFSI for a particular tax year is reduced by the lesser of: (1) the aggregate amount of the corporation's FS NOL carryovers to the year; and (2) 80% of the AFSI for the year computed without regard to FS NOL carryovers. An FS NOL is the amount of an AFSI loss (determined without regard to an FS NOL) for tax years ending after December 31, 2019. FS NOL carryovers can be carried over indefinitely.

The Notice provides that an FS NOL carried forward to the first tax year a corporation is an applicable corporation (and any subsequent tax years) is determined without regard to whether the corporation was an applicable corporation for any prior tax year. This is illustrated by an example in which an FS NOL generated by a calendar year taxpayer in 2020 is partially absorbed by positive AFSI in the taxpayer's 2021-2023 tax years, even though the taxpayer only becomes an applicable corporation in 2024.

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KPMG observation

The Notice favorably confirms that a corporation that becomes an applicable corporation (whether in 2023 or later) could have an FS NOL carryforward equal to net AFSI losses for tax years ending after December 31, 2019. This rule could help many taxpayers benefit from their financial statement losses reported during the COVID-19 pandemic for purposes of any potential CAMT liability, regardless of when they become an application corporation, assuming such taxpayers have not generated an amount of AFSI greater than such losses before they become applicable corporations. This may be an important diligence point in corporate acquisitions, and many smaller corporate targets presumably will not have had any reason to monitor their FS NOL profile prior to an acquisition. The fact that the Notice provides that a U.S. tax return can constitute an AFS if no financial statement is available arguably indicates that all U.S. corporate filers at least theoretically have AFSI and potentially FS NOLs.

The Notice does not address several important questions related to FS NOLs, including (1) whether Treasury will seek to impose loss limitation rules on FS NOLs (*e.g.,* similar to the section 382 and separate return limitation year rules applicable to regular tax net operating losses), and (2) whether FS NOLs are allocated to individual members of a TCG when a member leaves the group or remain with the TCG as a group-level attribute.

Section 13: Determining applicable corporation status

Section 13 of the Notice provides rules aimed at providing “additional clarity” in determining whether a corporation is an applicable corporation. Section 13 addresses section 52 aggregation, the rules that apply to members of FPMGs and the rules that apply to corporate partners.

As background, under the statutory rules, an applicable corporation is defined as a corporation (other than a REIT, RIC, or S Corporation) whose three-year average AFSI exceeds $1 billion. Under this three-year average AFSI test, a corporation is an applicable corporation if the average AFSI of the corporation in the three tax year period ending with any tested tax year exceeds $1 billion. Aggregation rules apply to determine whether the $1 billion threshold is satisfied.

Generally, the AFSI of any person that is treated as a member of a “single employer group” with that corporation under section 52(a) or (b) is included. Special aggregation rules apply if the corporation is a member of a FPMG.[30]

Section 52 aggregation, in general

The Notice provides guidance about section 52 aggregation. At a high level, section 52(a) aggregates corporate entities connected through more than 50% ownership. Section 52(b) provides that employees of trades or business (whether or not incorporated) that are under common control are treated as employed by a single employer.

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[30] As background, section 59(k)(2)(A) provides that a corporate member of a FPMG becomes an applicable corporation only if it satisfies both a modified version of the $1 billion average annual AFSI test (the “FPMG $1 billion test”) and has average annual AFSI over the three-year testing period equaling or exceeding $100 million (the “$100 million test”). For purposes of the FPMG $1 billion test, section 56A(c)(4), which limits AFSI of a foreign corporation to its effectively connected income, does not apply. In contrast, for purposes of the $100 million test, section 56A(c)(4) does apply.
Section 59(k)(2)(A) provides that, for purposes of the FPMG $1 billion test, all of the AFSI of all members of the FPMG is taken into account. The statute is not clear as to whether the AFSI of an entity that is not a member of the FPMG but is part of the tested corporation’s single employer group under section 52, is also taken into account to determine whether that tested corporation satisfies the FPMG $1 billion test. As described below, the Notice addresses this issue.
For the $100 million test, the special aggregation rule in section 59(k)(2)(A) for members of a FPMG does not apply, but the general aggregation of AFSI for members of a single employer group under section 52(a) and (b) does apply.

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Section 52(a) aggregation of corporations

The Notice generally restates current law in its discussion of section 52(a), providing an example of how section 1563(e)(2) results in attribution through a partnership.[31] The Notice also explains that a foreign corporation can be a member of a section 52(a) group for purposes of applying section 59(k)(1)(D).

KPMG observation

The statement that foreign corporations may be members of a section 1563 group (and thus section 52) reflects current law.

Section 52(b) aggregation of partnerships

The Notice recites the section 52(b) rules and then states that "[t]he constructive ownership rules under § 1563(d) and (e)[32] described in section 13.02(2) of this notice also apply for purposes of § 52(b) in determining members of the controlled group." The Notice also states that foreign entities (such as foreign partnerships) may be members of a section 52(b) single employer for purposes of applying section 59(k)(1)(D).

KPMG observation

Although not entirely clear, the Notice appears to indicate that Treasury intends to change the constructive ownership rules applicable for purposes of section 52(b). Currently, the regulations defining a group of trades or businesses under common control for purposes of section 52(b) (a "controlled group") apply certain constructive ownership rules in section 414. However, the Notice provides that the constructive ownership rules of section 1563(d) and (e) apply (or will apply) for purposes of section 52(b). This appears to represent a change from existing law, although one that would presumably be within Treasury's authority under sections 52(b) and 59. However, the Notice is not clear as to whether Treasury views this as a change in law and, if so, how Treasury intends to implement the change (*e.g.,* would the existing section 52(b) regulations be amended; if so, would section 1563 principles replace the currently cross-referenced section 414 rules).

The Notice does not explain the reason for applying section 1563(d) and (e) for purposes of defining a controlled group. One possible reason is to prevent "breaking" aggregation by using intermediate non-corporate entities that are not engaged in an active trade or business. The current regulations, in defining a "parent-subsidiary" controlled group, only provide for attribution as a result of holding an option. Accordingly, a parent entity that owns, indirectly through an intermediate entity, the majority of a lower-tier entity, potentially may not be part of a "parent-subsidiary" controlled group with lower-tier entity under the existing regulations. However, the Notice does not directly address the often

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[31] Under section 1563(e)(2), stock owned directly or indirectly, by or for a partnership is considered as owned by any partner having an interest of 5% or more in either the capital or profits of the partnership in proportion to his interest in capital or profits, whichever such proportion is greater.

[32] Section 1563(d) sets forth the rules for determining stock ownership and provides that stock owned directly or indirectly by application of the constructive ownership rules under section 1563(e) is taken into account. Thus, whether a corporation is a member of a controlled group depends on its direct ownership and certain constructive ownership rules. The constructive ownership rules that apply to both parent-subsidiary control groups and brother-sister control group include the ownership of stock options and certain ownership through partnerships, estates, and trusts. Specifically, stock owned, directly or indirectly, by a partnership is considered owned by a partner who owns a 5% or greater interest in the capital or profits of the partnership (in proportion to the partner's interest in capital or profits). Similarly, stock owned, directly or indirectly, by an estate or trust is considered as owned by a beneficiary, with an actuarial interest of 5% or more in the stock, to the extent of such actuarial interest. And stock owned by a grantor trust is considered to be owned by the grantor. Several additional constructive ownership rules apply to brother-sister control groups including attribution from corporations, spouses, and other family members.

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more significant issue of whether a non-corporate entity that is not engaged in a trade or business can constitute a "common parent organization" for aggregation purposes.

Section 52 aggregation and S corporations, RICS and REITs

The Notice makes clear that while S corporations, RICs, and REITs are excluded from the definition of an applicable corporation, such entities can be members of section 52 single employer groups.

KPMG observation

To the extent there was any doubt, this makes clear that the income of S corporations, RICs, and REITs is taken into account when determining if a related C corporation is in-scope as an applicable corporation. One implication of this is that the CAMT status of taxable REIT subsidiaries should be evaluated.[33]

FPMG scope rule

The Notice provides, for purposes of applying the FPMG $1 billion test, the AFSI of a taxpayer being evaluated for applicable corporation status ("Tested Corporation") that is a member of a FPMG includes both (1) the AFSI of all other members of the FPMG *and* (2) the AFSI of all persons treated as a single employer with the Tested Corporation by reason of section 52 aggregation to the extent such AFSI is not AFSI of a member of the FPMG.

KPMG observation

The Notice's interpretation of the inclusion of members included on an FPMG Consolidated AFS in the "special rule for foreign-parented multinational groups" in section 59(k)(2)(A) as being *in addition to*, rather than in lieu of, the section 52(b) rule referenced in section 59(k)(1)(D) is significant. Under the statute and prior guidance, many commentators believed that, for purposes of the $1 billion FPMG test, a Tested Corporation aggregated only the AFSI of other members of the FPMG. Section 59(k)(2)(D) authorizes the Secretary to provide regulations or other guidance applying the principles of section 59(k)(2), including rules to determine the entities included in a FPMG. This change has the potential to expand the number of U.S. subsidiaries of FPMG in-scope of CAMT and increase the compliance burden on FPMGs.

Partnership scope rule

The Notice provides a rule "disregarding the distributive share adjustment" for scope determination purposes.

As background, under section 56A(c)(2)(D), if a taxpayer (*e.g.,* a corporation) is a partner in a partnership ("corporate partner"), the taxpayer is generally required to adjust its AFSI to "only" take into account the taxpayer's distributive share of AFSI of the partnership (the "distributive share only" rule). The Secretary has the authority to provide otherwise. However, section 59(k)(1)(D) provides that, solely for purposes of determination of whether a corporation is an applicable corporation (i.e., the scope determination), a corporation's AFSI includes the AFSI of all persons treated as a single employer with the corporation under section 52(a) or (b). Additionally, section 59(k)(1)(D) "turns off" the distributive share only rule, although the

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[33] *See* Stephen J. Giordano and Monisha C. Santamaria, Why REITs Should Be Paying Attention to the Corporate AMT, Tax Notes International, June 26, 2023, p. 173.

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language and structure of the statute leave unclear the extent to which the distributive share only rule is “turned off.” In Notice 2023-7, Treasury provided that the distributive share only rule is inapplicable for all scope determination purposes.

Section 13.04 of Notice 2023-64 provides more details regarding what it means for the distributive share to be disregarded for all scope determination purposes. Specifically, it provides that for scope determination purposes, for partnership investments, taxpayers generally must use FSI, rather than AFSI. The guidance indicates that for scope determination purposes, a corporate partner generally “includes in its AFSI the FSI amount it reports with respect to its partnership investment (for example, under the fair value method or equity method), rather than its ‘distributive share’ of the AFSI of the partnership.”

KPMG observation

The direction to generally use FSI, rather than AFSI, and reference to the fair value method indicate that mark-to-market amounts with respect to partnership investments may be included for AFSI for scope determination purposes. Furthermore, the language suggests that the section 56A adjustments (e.g., with respect to depreciation or certain taxes) do not generally apply with respect to partnership income for scope AFSI purposes. This has the potential to increase (or possibly decrease) scope AFSI for corporations with partnership investments. However, this rule would appear to result in a less burdensome CAMT compliance regime. This is because when unadjusted FSI is used, a partner would not need any information from a partnership to determine whether it was in-scope as an applicable corporation.

Section 13.04 of the Notice appears to instruct partners not to use unadjusted FSI in three instances. The general rule providing that the inclusion amount with respect to a partnership for scope determination purposes cross-references both Sections 5.02(3)(c)(iii) and 5.02(3)(c)(vii) of the Notice – which, as discussed above, seems to provide some adjustment to FSI in situations where the partnership is book consolidated. Additionally, the general direction to use FSI, rather than AFSI, does not apply if the partnership and tested corporation are either members of the same section 52 single employer group or the partnership and tested corporation are members of the same FPMG group. In such an instance, the Notice instructs that “all the AFSI of the partnership is treated as the AFSI of the taxpayer….and in order to prevent duplication of income or loss from the partnership investment, the taxpayer does not include in its AFSI the FSI amount it reports with respect to the partnership investment.”

KPMG observation

The reference to Sections 5.02(3)(c)(iii) and 5.02(3)(c)(vii) raises questions because, as discussed above, the partnership sentence in Section 5.02(3)(c)(iii) and the example in Section 5.02(3)(c)(vii) are confusing. As Section 13.04(1) creates an equivalence between AFSI and FSI for certain scope determination purposes, one can query if the aforementioned partnership sentence speaks to both FSI and AFSI determination (at least for scope determination purposes).

With respect to partnerships that are members of the Tested Corporation’s section 52 single employer group or FPMG, the adjustments in section 56A(c) (*e.g.,* the depreciation rule) appear to apply.

Thus, while corporate partners generally will not need additional information from partnerships to determine if they are in scope, corporate partners will need information in some cases. For example, if a partnership is a member of the corporate partner’s section 52 single employer group or FPMG, the corporate partner will need to compute partnership AFSI to determine whether it is an applicable corporation. In the case of partnerships with CFC partners, when the Section 7 CFC partner distributive share rule modifies the Section 13 directive to disregard the distributive share rule, CFC partners will need to know their share of partnership AFSI so that their U.S. shareholders can evaluate their applicable corporation status.

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KPMG tax professionals further note that the latest Notice does not explicitly address CAMT liability issues for corporate partners and, as noted below, comments are requested on this issue.

Section 14: CAMT FTC

In determining an applicable corporation's CAMT liability, section 59(l) provides a CAMT FTC for any year in which an applicable corporation elects to claim an FTC for regular tax purposes. An applicable corporation's CAMT FTC for the year, under section 59(l)(1), is the sum of two amounts. The first amount ("CFC taxes") is equal to the lesser of (i) the applicable corporation's aggregate pro rata share of foreign taxes that are (1) "taken into account" on the AFS of each CFC with respect to which the applicable corporation is a U.S. shareholder and (2) paid or accrued (for federal income tax purposes) by each such CFC, and (ii) 15% of the applicable corporation's CFC adjustment under section 56A(c)(3) (the "CFC FTC limitation"). The second amount ("direct taxes") is equal to an amount of foreign taxes that are (1) taken into account on the applicable corporation's [AFS], and (2) paid or accrued (for federal income tax purposes) by the applicable corporation. Direct taxes, unlike CFC taxes, are not subject to any limitation, but also are not permitted to be carried forward. Section 59(l)(3) directs the Secretary to "provide regulations or other guidance as is necessary to carry out the purposes of this subsection."

The guidance confirms and clarifies certain fundamental aspects of the CAMT FTC regime. First, the Notice clarifies that a foreign tax (whether a CFC tax or direct tax) becomes eligible to be claimed as a CAMT FTC (an "eligible tax") in the year it is paid or accrued for U.S. federal income tax purposes by either an applicable corporation or a CFC, "provided [such foreign tax] has been taken into account on the AFS" of such applicable corporation or CFC. As noted above, for purposes of the CAMT FTC and the tax adjustment under section 56A(c)(5), a foreign income tax is considered "taken into account" on an AFS if it is reflected in a journal entry used to determine amounts on the AFS *for any year*, irrespective of whether the tax affects the taxpayer's FSI at the time of the journal entry.

KPMG observation

Fixing the timing of the CAMT FTC to the year in which the foreign tax is paid or accrued for U.S. federal income tax purposes aligns the CAMT FTC more closely with regular FTC, and thus appears to de-emphasize the importance of the "taken into account" requirement for the CAMT FTC. The use of the phrase "provided [the foreign tax] *has been taken into account*," however, would seem to indicate that the tax must have been reflected as a journal entry either in the year it is treated as paid or accrued for U.S. federal income tax purposes or in an earlier year. Under this interpretation, a foreign tax that is paid or accrued in a year *before* such tax is taken into account on an AFS would never be creditable for CAMT. However, in practice, a tax will generally be reflected as a journal entry in a year that precedes or coincides with the year such tax is considered paid or accrued for U.S. federal income tax purposes, except in the case of certain foreign tax redeterminations, discussed directly below.

The Notice provides that a foreign tax paid or accrued as a result of a foreign tax redetermination (as defined in Treas. Reg. § 1.905-3(a)) is only eligible for a CAMT FTC if the taxpayer was an applicable corporation in the year to which the foreign tax redetermination relates (the "relation-back year"). Moreover, even if the foreign tax is taken into account on the taxpayer's AFS in a later year, the Notice provides that the foreign tax redetermination is only permitted as a CAMT FTC in the relation-back year.

KPMG observation

The rule for foreign tax redeterminations is consistent with the general timing rule for CAMT FTCs, which permits a CAMT FTC for a foreign tax in the year such tax has been paid or accrued for federal

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income tax purposes. However, the rule seems to modify the apparent requirement in the Notice that the tax must be reflected on an AFS as of the year it has been paid or accrued. Thus, in the case of a foreign tax redetermination, a CAMT FTC can arise in the relation-back year even though the foreign tax is not taken into account on an AFS until a subsequent year (*e.g.,* because the taxpayer did not reserve for the foreign tax in the relation-back year).

The requirement that the taxpayer must have been an applicable corporation in the relation-back year to claim a CAMT FTC may prevent many taxpayers from being able to claim a CAMT FTC for foreign tax redeterminations. This may result in a permanent mismatch between foreign taxes allowed as a CAMT FTC and those taken into account in the adjustment for foreign taxes under section 56A(c)(5), which is based on when the tax affects FSI rather than when it is paid or accrued for federal income tax purposes. For example, if the taxpayer is an applicable corporation in the year when the foreign tax redetermination decreases FSI, the guidance would seem to require an increase to AFSI for the amount of the foreign tax redetermination under section 56A(c)(5). However, if the taxpayer was not an applicable corporation in the relation-back year, it would never be able to claim a CAMT FTC for the foreign tax arising from the foreign tax redetermination. The same mismatch would also exist if a foreign tax redetermination results in a refund (as opposed to an increase to tax) in the later year, except that this mismatch could inure to the benefit of the taxpayer. In that case, the adjustment under section 56A(c)(5) would *reduce* the taxpayer's AFSI, while the taxpayer's CAMT FTCs for that year would not be reduced by the redetermination. Finally, a foreign tax redetermination that relates back to a year in which the taxpayer is not an applicable corporation could increase a CAMT liability if such foreign tax gives rise to an FTC for regular tax purposes that is permitted to be carried forward into a year in which the taxpayer is an applicable corporation, because such tax will not give rise to a CAMT FTC that is also permitted to reduce tentative minimum tax.

The lack of coordination between the tax adjustment in section 56A(c)(5) and the CAMT FTC seems to suggest that Treasury does not see the tax adjustment as merely an analog to section 78 in the context of a regular FTC, but instead views its purpose as establishing a pre-tax AFSI base, except, for this purpose, still taking into account the impact of state and local taxes on FSI. This is further reinforced by the government's decision in the Notice not to exercise its regulatory authority in section 56A(c)(5) to limit the adjustment to foreign taxes for which the taxpayer claims a credit for regular tax.

Additionally, the decision to limit the availability of a CAMT FTC for foreign tax redeterminations to years in which the taxpayer was an applicable corporation strongly implies that Treasury will promulgate rules confirming that a taxpayer will not be allowed to claim CAMT FTCs for CFC taxes paid or accrued in years preceding the taxpayer's status as an applicable corporation, either because CAMT was not yet effective or because the taxpayer did not yet meet the requirements to be an applicable corporation. The impact of this rule would be to ensure that CFC taxes paid or accrued before the taxpayer is subject to CAMT are not permitted to be carried forward under section 59(l)(2) in order to reduce tentative minimum tax when such taxpayer is subject to CAMT.

The Notice provides that a taxpayer determines the amount of its CFC taxes and the CFC FTC limitation applicable to such CFC taxes on an aggregate basis with respect to all CFCs in which it is a U.S. shareholder.

KPMG observation

The Notice confirms that the CFC FTC limitation is determined by reference to the aggregate CFC adjustment under section 56A(c)(3), rather than by reference to the CFC adjustment with respect to each CFC. This rule, which is consistent with KPMG's initial interpretation of the statute, effectively permits unlimited cross-crediting of CAMT FTCs with respect to a U.S. shareholder's CFCs. The CFC FTC limitation, however, ensures that CFC taxes are not permitted to be cross-credited against

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AFSI earned directly by an applicable corporation (including through branches). Because AFSI earned directly by an applicable corporation (including through branches) cannot be offset by CFC taxes, whereas AFSI earned indirectly through CFCs can be offset not only by CFC taxes but also foreign taxes paid or accrued directly by the applicable corporation itself (including through its branches), it is important to accurately ensure that worldwide income and expenses (e.g., stock-based comp) are properly attributed between the applicable corporation and its CFCs.

Section 59(l)(3) directs the Secretary to "provide regulations or other guidance as is necessary to carry out the purposes of this subsection." The Notice also clarifies that, for purposes of the CAMT FTC, an applicable corporation or CFC that is a partner in a partnership is treated as paying or accruing its share of the foreign taxes paid or accrued at the partnership level ("partnership foreign taxes"), including partnerships held through a tier of partnerships or other pass-through entities. Separately, as noted above, in discussing when taxes are taken into account for purposes of the tax adjustment, the Notice states that an income tax, including a foreign income tax, that is taken into account on a partnership's AFS is also considered taken into account on the AFS of its partners for CAMT FTC purposes.

KPMG observation

That partnership foreign taxes are eligible for a CAMT FTC is a welcome clarification, given that the statute is silent as to the treatment of partnership foreign taxes. As KPMG recommended in a comment letter on partnership CAMT FTCs, the guidance confirms, both for applicable corporation and CFC partners, that a partner is treated as paying or accruing the partnership foreign taxes and that reflection on the partnership's AFS is sufficient to satisfy the "taken into account" on the AFS prong. For this purpose, the Notice does not differentiate between partnership foreign taxes paid or accrued by a consolidated, equity method, or fair value accounted partnership. Therefore, for liability purposes it appears that a partner of even a fair value accounted partnership may claim a CAMT FTC with respect to a foreign tax paid by such partnership, to the extent such taxes are taken into account on the partnership's AFS notwithstanding that such tax is only indirectly "taken into account" on the partner's AFS (i.e., through a decrease in the value of the partnership interest by reason of taxes paid).

The Notice does not, however, provide any clues as to how a partner would determine its "share" of partnership taxes; it notably does not use the term "distributive share," which is used in the adjustment for partnership AFSI in section 56A(c)(2)(D) (which the request for comments notes is still being studied). Accordingly, absent further guidance, it may be reasonable for a partner to treat its share of paid or accrued partnership foreign taxes as the amount permitted for regular tax purposes, determined under section 704(b) and the regulations thereunder, as KPMG recommended in its comment letter.

Section 15: Applicability date

The Notice states that Treasury intends to publish proposed regulations consistent with the interim guidance in the Notice, as well as the guidance in Notice 2023-7 (as modified and clarified in the Notice) and Notice 2023-20 that are anticipated to apply for tax years beginning on or after January 1, 2024. Taxpayers may rely on the interim guidance for tax years ending on or before the date the proposed regulations are published. However, regardless of when the proposed regulations are published, taxpayers may rely on the interim guidance for tax years beginning before January 1, 2024.

KPMG observation

In Notice 2023-7 and Notice 2023-20, Treasury indicated that the forthcoming regulations were anticipated to apply for tax years beginning on or after January 1, 2023. The Notice delays this

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anticipated applicability date by one year. This delay suggests that Treasury does not anticipate issuing proposed regulations by the end of 2023, which would permit the final regulations to apply to 2023 calendar tax years under section 7805(b)(1)(B), or final regulations by February 16, 2024, 18 months after the date of the enactment of the Inflation Reduction Act (August 16, 2022), which is the deadline under section 7805(b)(2) for issuing regulations that could apply retroactively to all 2023 tax years. Treasury does have the authority to apply final regulations that incorporate the interim guidance in the notices to all years ending on or after the date of such notices under section 7805(b)(1)(C), regardless of when such regulations are finalized. However, by delaying the anticipated applicability date in the Notice, Treasury has indicated that they do not intend to exercise that authority.

The Notice indicates that taxpayers may rely on the provisions of Notice 2023-7, Notice 2023-20, and the Notice for tax years beginning before January 1, 2024, and for any other tax year beginning before the issuance of the proposed regulations. For this purpose, the Notice does not appear to require that a taxpayer relying on one provision of a notice also rely on any other provision of the same or another notice.[34] The lack of a consistency requirement may provide taxpayers significant flexibility in determining which, if any, of the interim guidance the taxpayer chooses to rely on during the reliance period.

Section 16: Request for comments

Comments on the Notice's contents in general are requested, along with comments on specific issues. With respect to specific issues, the Notice distinguishes between those included in the Notice's substantive rules as well as those not included. With respect to the former, Treasury set forth several questions directed at three of the preceding substantive sections of the Notice, i.e., Section 9 on depreciation adjustments, Section 10 on qualified wireless spectrum adjustments, and Section 11 on AFSI adjustments to prevent duplications and omissions. For instance, regarding depreciation adjustments Treasury acknowledged having received "helpful comments" (in response to Notice 2023-7) and are continuing to study the use of simplified methods and safe harbors.

With respect to specific issues related to rules not included in the Notice, Treasury identified issues that are expected to become the subject matter of forthcoming proposed regulations. For instance, as discussed above, Treasury requested specific comments on approaches that should be considered to address the potential duplication of income with respect to a CFC by reason of the application of the dividend inclusion rule of section 56A(c)(2)(C) and the CFC adjustment rule of section 56A(c)(3). Treasury also specifically requests comments on the treatment of unrealized marked-to-market gains and losses; the partnership distributive share rule and the section 56A(c)(11) adjustment for certain benefit plans.

A number of the requests for comments indicate that Treasury is considering a number of rules that would further complicate the CAMT regime. For example, it appears Treasury is considering rules that would require adjustments to AFSI to "clearly reflect income," including in the context of related party transactions. Written comments should be submitted by October 12, 2023. However, the government will consider any written comment submitted after October 12, if such consideration will not delay the issuance of forthcoming proposed regulations.

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[34] But see Section 9.02 of the Notice, which requires taxpayers that choose to rely on the interim guidance in Section 4 of Notice 2023-7 on or after September 12 apply the guidance in Section 4 of Notice 2023-7, as modified and clarified by this Notice.

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Conclusion

Notice 2023-64 provides a number of welcome rules and clarifies certain outstanding issues while simultaneously adding to CAMT's many mysteries and uncertainties. As discussed above, multiple provisions in the Notice lend themselves to varied interpretations and the interaction among certain provisions within the Notice is unclear. However, given the discussion of the effective date of forthcoming proposed regulations (which for pre-2024 tax years allows taxpayers to rely on reasonable interpretations of the statutory language and, at their discretion, the previously issued notices), taxpayers (and tax advisors) may be wise to leave some of the mysteries of the latest CAMT Notice unresolved and be grateful that Treasury has made the sensible decision to be less proscriptive for 2023 tax years.

This also means that taxpayers that have yet to ascertain whether they are applicable corporations can be viewed to have all they need to begin the 2023 CAMT compliance process. Although a number of key questions remain unanswered, Treasury has provided enough guidance to allow taxpayers to reasonably perform both the CAMT scope and liability analyses. Additionally, since the CAMT scope determination is based upon a look-back at the prior three tax years, taxpayers should already have all the data necessary to review the $1 billion test.

Taxpayers who have ascertained that they are applicable corporations may need to carefully study the statute and guidance—to determine their potential liability based on the statutory rules and/or notices, whether they want to submit comment and what additional resources their tax departments will need to comply with the CAMT on a go-forward basis.

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